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THE PRINCIPLES OF THE LAW RELATING TO  
CORPORATE LIABILITY FOR ACTS OF PRO-  
MOTERS.

## PART I.

### PROMOTERS: THEIR RELATIONSHIPS AND LIABILITIES.

#### CHAPTER I.

##### § 1. *Who are promoters.*

It may be said, generally, that any person who does an act with reference to the formation of a company or in aid of its organization is, as regards that act, a "promoter" of the company. As the term originated in trade and not in the law no technical legal definition is possible, but it has been well described in the following manner: "In the law relating to corporations, those persons are called 'promoters' of a company who first associate themselves together for the purpose of organizing the company, issuing its prospectus, procuring subscriptions to the stock, securing a charter, etc."<sup>1</sup> Or as was said by Bowen, J.,<sup>2</sup> it is a term, "usefully summing up in a single word a number of business operations familiar to the commercial world, by which a company is generally brought into existence."

<sup>1</sup> Black's Law Dictionary.

<sup>2</sup> Whaley Bridge Calico Printing Co. v. Green, L. R. 28, Q. B. D. 351.

The only requisite, therefore, to bring one within the meaning of the term is, that he shall have performed some act with a view to the formation of a company. As to what acts are usually done in the projection or floating of a corporation, is more a matter of business experience than of law, but among the most usual and necessary might be mentioned (those to which reference has already been made), viz., the issuing of the prospectus, inducing others to subscribe for stock, and obtaining the charter.

§ 2. *Relationship between corporations and their promoters.*

Now, although any act done with reference to the creation of a company will constitute one a promoter, it does not follow that a status is created. The relationship thereby established has no significance except as regards the act done. That is to say: with respect to that act, the one doing it is a promoter and subject to all the rights and liabilities which that term implies; but if he should subsequently abandon the enterprise he could not be held for acts done after his connection with the project had ceased, on the broad ground that he was a promoter of the company.

What rights and liabilities, then, does this term imply? Promoters are universally held to be corporate fiduciaries, standing in a relation of trust and confidence towards the projected company and the stockholders, and bound to exercise *uberrimam fidem* towards both.<sup>1</sup> This arises from the fact that promoters usually hold themselves out as deeply interested in the proposed corporation, and as acting for it. They take upon themselves to bring into existence this creature of the law which, in its inchoate state, is completely at their mercy, unprotected by impartial agents acting solely for the benefit of the stockholders. In view of these circumstances, the acts of the promoters are strictly scrutinized.<sup>2</sup> Since they

<sup>1</sup> *Densmore Oil Co. v. Densmore*, 64 Pa. 43 (1870); *Chandler v. Bacon*, 30 Fed. 538 (1887); *Emma Silver Mining Co. v. Grant*, L. R. 11 Ch. Div. 918 (1878); *Simons v. Vulcan Oil & Mining Co.*, 61 Pa. 202 (1869); *McElhenny's App.*, 61 Pa. 188 (1869); *Bagnell v. Carlton*, L. R. 6 Ch. Div. 376 (1877).

<sup>2</sup> *Sombrero Phosphate Co. v. Erlanger*, L. R. 3 App. Cas. 1218.

stand in a trust relation, they are prohibited from making any profit other than is common to all the stockholders, or receiving any secret advantage whatsoever, and this relation exists even in favor of those who subsequently become stockholders.<sup>1</sup>

The results of the cases on this question may be summed up in four propositions :

(1.) Where a promoter buys property intending to sell it to the company (already in process of formation) he cannot make a profit on the transaction without the fullest disclosure.<sup>2</sup>

(2.) But where one owns property he is at liberty to form a company and sell to it at any price and without disclosing his profit : provided, only, however, that he make no fraudulent misrepresentations.<sup>3</sup>

(3.) Where one buys property and soon after begins to promote a company, and declares that he bought the property for the company, and effects a sale to the company, he is liable for any profit made, on the ground that he has alleged that he acted as an agent in the matter, and may not now be heard to claim that he acted only for himself.<sup>4</sup>

(4.) If a promoter receive a gift or commission from the vendors of property for arranging a sale to the company, he must account therefor (less the amount of his disbursements) for he may not secretly derive any benefit over the other members in any transaction to which the intended company is a party.<sup>5</sup>

It results also from this trust relation that if the project fails, the promoters are bound to return the subscriptions to the stockholders, and failure to do so renders them liable as for a misuse of trust funds.<sup>6</sup>

It is evident from these results that this relation is of a fiducial character and is similar to that existing between trustee and *cestui que trust*, principal and agent, or partner and

<sup>1</sup> Densmore Oil Co. v. Densmore, 64 Pa. 43 (1870).

<sup>2</sup> Emma Silver Mining Co. v. Grant, L. R. 11 Ch. Div. 918 (1878).

<sup>3</sup> Densmore Oil Co. v. Densmore, 64 Pa. 43 (1870).

<sup>4</sup> Simons v. Vulcan Oil Co., 61 Pa. 202 (1869).

<sup>5</sup> Emma Silver Mining Co. v. Grant, L. R. 11 Ch. Div. 918 (1878).

<sup>6</sup> Nockles v. Crosby, 3 B. & C. 814.

partner. In fact, in *Bagnell v. Carlton*,<sup>1</sup> the Court treats of the promoters as trustees; Lord Cotton, in the same case, deals with them as agents of the company; and Sharswood, J., in the leading case of *Densmore Oil Co. v. Densmore*,<sup>2</sup> draws an analogy between the position of promoters in respect of the company, and the relations of partners *inter sese*.

In deciding as to whether promoters were liable to turn over to the company secret profits, he said: "It is a familiar principle of the law of *partnership*, that one partner cannot buy and sell to the partnership at a profit; nor if a partnership is in contemplation merely, can he purchase with a view to a future sale without accounting for the profit." And on this ground he rested the decision.

It is a mistake, however, to suppose that the analogy is perfect as between promoters and either trustees, agents, or partners. Strictly speaking, a promoter is none of these, but occupies a position in respect of which the law imposes certain duties similar to those imposed in the other instances. If one may use the term, it is a quasi-agency or trusteeship.<sup>3</sup> The subject becomes of practical importance only with regard to the suggestion, that the promoters are agents of the company.

It is clear that if a promoter is treated as a technical agent, then the corporation must be held liable for the promoters acts done within the scope of his agency. That there cannot be an agent when no principal is in existence seems equally clear. We shall later have to discuss a line of cases in which it was held that a technical agency exists, but reason and the great weight of authority are against the proposition, and for the present it is sufficient to say that the idea has been thoroughly discredited.<sup>4</sup> The relationship, therefore, between the promoter and the company is that of corporate fiduciary, and is similar in its obligations to that of trustee or agent.<sup>5</sup>

The relationship ceases to exist when the corporation comes into being, though it has been suggested that, even after

<sup>1</sup> 6 Ch. Div. 371 (1877).

<sup>2</sup> 64 Pa. 43 (1870).

<sup>3</sup> *Chandler v. Bacon*, 30 Fed. 538 (1887).

<sup>4</sup> See *infra*.

<sup>5</sup> *Chandler v. Bacon*, 30 Fed. 538 (1887).

incorporation, those engaged in placing the stock may still be called promoters.<sup>1</sup>

§ 3. *Relationship of promoters inter sese.*

It is very generally stated in America that the projectors of a company are partners, and that their mutual rights and duties are determined by the law applicable to partnerships.<sup>2</sup> In England, however, the theory obtains that the promoters do not necessarily stand in this relation to each other, though they may do so under certain circumstances. The actual position which they occupy in any given case is a question of fact for the jury.<sup>3</sup>

Under the American rule, it is logically held that one promoter cannot recover from another for anything due on account of the formation of the company, in analogy to the familiar doctrine of partnerships that one partner cannot recover from another for anything due on account of the partnership business.

While the American doctrine thus broadly stated has undoubtedly a just application in certain cases, it must not be taken to mean that anyone who shall have done some act with reference to the formation of the company, and thereby become as to such act a promoter, is the partner of all others who have similarly acted, and therefore liable to be charged for their acts. Such a result would be unjust and could subserve no good purpose. The rule must be understood to provide that all those who act jointly in any transaction or series of transactions with respect to the corporate formation, are, in so doing, partners. The case of *Witmer v. Schlatter*<sup>4</sup> was one in which the doctrine of partnership was held applicable. That was an action of assumpsit brought against Schlatter and one hundred and seventy-six others as partners, who under the title of the "Contracting Committee of the Phila. &

<sup>1</sup> Bramwell, J., in *Tuycross v. Grant*, 2 C. P. Div. 503.

<sup>2</sup> Redfield on R. R., p. 11, § 3; *Witmer v. Schlatter*, 2 Rawle, 329 (1831); *Roberts Mfg. Co. v. Schlich*, 64 N. W. 826 (Minn. 1895); *Smith v. Warden*, 86 Mo. 399.

<sup>3</sup> *Milburn v. Codd*, 7 B. & C. 419, s. c. 1 M. & R. 238.

<sup>4</sup> 2 Rawle, 329 (1831). See also *Brewster v. Hatch*, 25 N. E. 505 (1890).

Pittsburgh Transportation Co." were carrying on business intending to become incorporated. They authorized one Harper to enter into a contract with the plaintiff in behalf of the corporation afterwards to be formed. Suit was brought against the individual members and a plea in confession and avoidance entered by some of the defendants.

Gibson, C. J., held: "Against those who pleaded, the record is undoubtedly that all who were alleged to be partners are so in fact; but, although the fact of partnership may be established by the separate admissions of all, it cannot be by the admissions of less than all, for the plain reason that a confession is competent to effect none but him who made it." "We are, therefore, of opinion that the parties to the contract are personally liable; but for the insufficiency of the evidence of partnership as to some of the defendants, a new trial is awarded."

The rule having been misinterpreted, however, the court, in *Railroad Gazette v. Wherry*,<sup>1</sup> said: "It cannot be contended that anyone who participates as a projector in the organization of a proposed corporation, can be held individually liable for every contract which any other projector sees fit to make in the name of the contemplated corporation, although such contract is made without the authority, sanction or knowledge of the party sought to be held liable."<sup>2</sup>

It would seem, therefore, that any liability to be charged upon a promoter, for the acts of his fellow promoters, must rest rather upon the principles of agency than of partnership,<sup>3</sup> though wherever the promoters have entered into such relations that the elements of a partnership are present, all the consequences of such a relation follow, and the act of one done within the scope of the undertaking binds all,<sup>4</sup> and each must act with entire good faith as regards the others.<sup>5</sup> Under any other circumstances, however, there is no relation of

<sup>1</sup> 58 Mo. App. 423 (1894).

<sup>2</sup> See also *Johnson v. Corser*, 25 N. W. 799 (Minn. 1885).

<sup>3</sup> *Hurt v. Salisbury*, 55 Mo. 316 (1874); *Beach on Corps.*, § 159

<sup>4</sup> *Brewster v. Hatch*, 25 N. E. 505 (1890).

<sup>5</sup> *Densmore Oil Co. v. Densmore*, 64 Pa. 43 (1870).

confidence between the promoters, and they may deal with each other at arm's length.<sup>1</sup>

This being so, the distinction attempted to be drawn by some writers between the English and American theories as to the relationship existing between the promoters *inter sese*, would seem to be of little practical importance, as there is a substantial uniformity in the results reached.

#### § 4. *Personal liability of promoters for contracts made in the corporate name.*

Having considered the relationship in which promoters stand to the corporation and to each other, it remains to inquire how far they become personally responsible for their acts done, or contracts made, in behalf of the corporation which they have undertaken to create. And, first, it may be taken as self-evident, that where the contract is not in fact made on the faith of the corporation, but with the promoter personally, even though it were intended for the benefit of the future company, the promoter is individually liable; for the engagement is his own.<sup>2</sup>

A corollary to this proposition is that where the contract on which a plaintiff is attempting to hold a projector personally liable, was made expressly between the plaintiff and the intended company, the plaintiff assuming the risk that such a company would be formed, and that when it came into existence it would bear the burden, and pay the plaintiff's claim, no responsibility rests upon the promoter.<sup>3</sup>

In *Whitney v. Wyman*,<sup>4</sup> the defendant and others, describing themselves as the "Prudential Committee of the Grand Haven Fruit Basket Company," wrote to Whitney stating that the company was partially organized, that certain machinery would

<sup>1</sup> *Densmore Oil Co. v. Densmore*, 64 Pa. 43 (1870).

<sup>2</sup> *Ruby Chief Mining Co. v. Gurley*, 29 P. 668 (Colo. 1892); *Perry v. Little Rock, Etc., R. R.*, 44 Ark. 383 (1884); *Carmody v. Powers*, 26 N. W. 801 (1886); *Wilbur v. N. Y. Co.*, 12 N. Y. Supp. 456; *Heleca Gold Mining Co. v. O'Neill*, 19 N. Y. Supp. 592.

<sup>3</sup> *Whitney v. Wyman*, 101 U. S. 392. See *contra* (an old case) *Furnival v. Coombs*, 5 M. & G. 736; *Landman v. Entwistle*, 7 W. H. & G. 632.

<sup>4</sup> 101 U. S. 392.



be needed, and ordering the machinery in the name of the company. Whitney addressed his reply to the "Grand Haven Fruit Basket Company," stating that the machinery was in process of construction. The goods were charged on the plaintiff's books to the company, but no payment having been made he sued the members of the committee personally.

Swayne, J., held that there could be no recovery, saying: "It seems to us entirely clear that both parties understood and meant that the contract was to be, and in fact was, with the corporation and not with the defendants individually."

In *Landman v. Entwistle*,<sup>1</sup> Parke, B., said: "It is clear that plaintiff undertook to do the work, not upon a contract with the provisional committee, but looking to the chance of the scheme succeeding and of there being funds available for the payment of his claim."<sup>2</sup>

In the absence of any express stipulation of this sort, exempting the promoter from liability, he is responsible for all acts done or contracts made by him or with his authority, though they were so done or made in the name of the corporation;<sup>3</sup> and this is so whether the proposed corporation is never formed,<sup>4</sup> or fails,<sup>5</sup> and even though incorporation were completed and the company had made itself responsible.<sup>6</sup> In the latter case the plaintiff has a choice of remedies against the promoter or the company,<sup>7</sup> for the reason that the action of the company by which it becomes bound is in effect the making of a new contract, and that therefore the original agreement between the plaintiff and the promoter is unaffected.<sup>8</sup>

The cases under this head may be divided into two classes: (1.) Those in which the party contracting with the promoter

<sup>1</sup> 7 W. H. & G. 632.

<sup>2</sup> See also *Hersey v. Tully*, 44 P. 854 (Colo. 1896).

<sup>3</sup> *Frendall v. Taylor et al.*, 26 Wis. 286 (1860).

<sup>4</sup> *Johnson v. Corser*, 25 N. W. 799 (Minn. 1885).

<sup>5</sup> *Roberts Mfg. Co. v. Schlich*, 64 N. W. 826 (Minn. 1895); *Hurt v. Salisbury*, 55 Mo. 316 (1874); *Weatherford R. R. v. Granger*, 24 S. W. 795 (Texas, 1894); *Kerridge v. Hesse*, 9 Car. & Payne, 200.

<sup>6</sup> *Queen City Furniture Co. v. Crawford*, 30 S. W. 163 (Mo. 1895).

<sup>7</sup> *Scott v. Ebury*, 36 L. J. C. P. 161.

<sup>8</sup> *Queen City Furniture Co. v. Crawford*, 30 S. W. 163 (Mo. 1895). See discussion, *infra*.

believed that the corporation, in whose name the contract was made, was in existence. (2.) Those in which he knew that the corporation was in process of formation only. Let us consider the grounds upon which the promoter's liability rests, in connection with each of these classes separately.

(1.) Where the promoter has not disclosed the inchoate condition of the company in whose name he contracts, he may be held liable for breach of warranty of authority, on the ground that where one contracts as agent he impliedly warrants that he has authority from his principal so to act. To have such authority is manifestly impossible where the principal is not yet in existence.<sup>1</sup> He can also be held liable on the further ground that, "where an alleged principal could not have authorized the contract, then it is plain from the beginning that the contract can have no operation at all unless it binds the professed agent. It is construed accordingly *ut res magis valeat quam pereat*, and he is held to have contracted in person."<sup>2</sup>

(2.) It would seem that it is this latter principle alone which can be applied where the projector has disclosed the incomplete condition of the company, or that fact has become known to the other contracting party through extraneous sources.

### § 5. *Liability for torts.*

Manifestly, promoters should be held liable for torts committed in the formation of a corporation, as in any other transaction, and it has accordingly been held that they are liable in deceit for false representations made to induce subscriptions to stock.<sup>3</sup>

### § 6. *Recapitulation.*

From the foregoing discussion it may be concluded, that while promoters stand in a position of trust towards the company, they are technically neither trustees nor agents, and that unless they expressly stipulate against personal liability on their contracts they will be liable, although said

<sup>1</sup> Bishop on Contracts, § 100; Collins v. Wright, 7 E. & B. 301.

<sup>2</sup> Pollock on Contracts. \* 107.

<sup>3</sup> Gerhard v. Bates, 2 El. & Bl. 476.

contracts be made in the name and for the benefit of the proposed corporation, and in spite of the fact that the corporation receives the benefit and assumes the obligation.

## PART II.

### THEORIES UPON WHICH THE CORPORATE LIABILITY HAS BEEN ENFORCED.

#### CHAPTER II.

#### THE COMPANY NOT LIABLE FOR ACTS OF PROMOTERS.

##### § 1. *Of the rule generally.*

It may be safely said that the rule is now universally established, that a corporation cannot be bound by the acts of its promoters, *qua* promoters, before it comes into existence. A very carefully considered decision in which this conclusion is reached, and a case typical of the American authorities, is that of *Weatherford, Etc., R. R. v. Granger*.<sup>1</sup> The Court there says: "There are some propositions affecting this question upon which the authorities seem to be in substantial accord. A promoter, though he purport to act on behalf of the projected corporation and not for himself, cannot be treated as agent, because the nominal principal is not then in existence; and hence, where there is nothing more than a contract by a promoter in which he undertakes to bind the future corporation, it is generally conceded that it cannot be enforced."

The reason here given is the fundamental one upon which the rule rests, and in view of the unanimity of the decisions upon the point, a further discussion would seem to be unnecessary.<sup>2</sup>

<sup>1</sup> 24 S. W. 795 (Texas, 1894).

<sup>2</sup> In *re* Empress Engineering Co., 16 Ch. Div. 125 (1880); In *re* Northumberland Avenue Hotel Co., 33 Ch. Div. 16 (1886); *Perry v. Little Rock, Etc., R. R. Co.*, 44 Ark. 383 (1884); *Marchand v. Loan and Pledge Assn.*, 26 La. Ann. 389 (1874); *Davis & Rankin v. Maysville Creamery Assn.*, 163 Mo. App. 477 (1895); *Western Screw Co. v. Cousley*, 72 Ill. 534 (1874); In *re* Hereford Iron Works Co., L. R. 2 Ch. Div. 621 (1876); *Gunn v. Assurance Co.*, 12 C. B. N. S. 694 (1882); *Hawkins v. Gold Co.*, 52 Cal. 513 (1877); *Morrison v. Gold Co.*, 52 Cal. 306 (1877); *Pittsburgh*

It was, indeed, suggested in *M'Dermott v. Harrison*,<sup>1</sup> that "the rule that the promoters cannot bind a corporation subsequently to be formed," does not apply to private corporations, but only to those exercising a franchise of a public or *quasi* public character. As the case relied on by the Court as authority for this proposition<sup>2</sup> was a suit between two former promoters of a company, on a contract made with regard to the future management thereof (they being the sole proprietors), and as the company was in no way implicated in the action, and the decision was merely that such a contract was not illegal as purporting to regulate the action of the intended company, the suggested distinction seems to be without the support of authority. It has not been followed elsewhere.

§ 2. *Rule not applicable where there is a de facto corporation.*

If, instead of a case in which a promoter has acted for an inchoate company, one is supposed in which a *de facto* corporation has acted in its own behalf, the question may arise whether if the body subsequently discovered the defect in its organization and completed the quota of the statutory requirements, the duly incorporated company becomes bound by the acts of the *de facto* organization.

It would seem that there can be no objection in theory or

& Tenn. Copper Co. v. Quintrell, 20 S. W. 284 (Texas, 1892); Huron Printing Co. v. Kittleson, 57 N. W. 233 (S. D. 1894); Schreyer v. Co., 43 P. 719 (Oregon, 1896); Stowe v. Flagg, 72 Ill. 397 (1874); Weatherford R. R. Co. v. Granger, 24 S. W. 795 (Texas, 1894); Arapahoe Co. v. Platt, 39 P. 584 (Colo. 1895); Long v. Citizens' Bank, 29 P. 878 (Utah, 1892); Battelle v. Cement Co., 33 N. W. 327 (Mo. 1887); Buffington v. Bardou, 50 N. W. 776 (Wisc. 1891); McArthur v. Printing Co., 51 N. W. 216 (Minn. 1892); Joy v. Manion, 28 Mo. App. 55 (1887); Hill v. Gould, 129 Mo. 106 (1895), *dictum*; Stowe v. Flagg, 72 Ill. 397 (1874); Gent v. Ins. Co., 107 Ill. 652 (1883); Franklin Fire Ins. Co. v. Hart, 31 Md. 60 (1869); Munson v. R. R., 103 N. Y. 58 (1886); Heleca Gold Co. v. O'Neill, 19 N. Y. Supp. 592 (1892); Rogers v. Texas Land Co., 134 N. Y. 197 (1892); Oakes v. Cattaraugus Co., 143 N. Y. App. 430 (1894); Burden v. Burden, 4 N. Y. Supp. 499; Payne v. Coal Co., 10 Exch. 281 (1854); Caledonian R. R. v. Helensburg, 2 Macq. H. of L. 393 (1856).

<sup>1</sup> 9 N. Y. Supp. 184 (1890).

<sup>2</sup> Lorillard v. Clyde, 86 N. Y. 384.

upon grounds of policy to holding the company liable. The rule under discussion has no application, for it refers merely to corporations not *in esse*. In contemplation of law, however, a *de facto* company has an actual existence as a corporation, and the fulfilment of the formal requisites adds nothing to the corporate vitality, nor does it in any true sense change the constitution or character of the body. The act of one was in all fairness and equity the act of the other. So it has been held that, under such circumstances, the company after due organization, is bound by its previous acts, for the acts are its own and not those of mere promoters.<sup>1</sup>

§ 3. *Company bound where the charter so provides.*

It has been decided, and there are numerous dicta to the same effect, that if the charter provides that a contract made by promoters of a company shall be binding upon it, or if the charter gives to the promoters power to bind the corporation, and they exercise the power so given before organization is completed, then in either event the corporation upon coming into existence will be bound.

The case of *Tilson v. Town of Warwick Gas Light Co.*,<sup>2</sup> was an action of debt brought by the attorneys who had obtained the act incorporating the defendant company. The act provided that all costs of procuring it should be paid and discharged by the company. Bayley, J., said: "Now, where an Act of Parliament casts upon a party an obligation to pay a specific sum of money to particular persons, the law then enables those persons to maintain an action of debt," and judgment was thereupon rendered for the plaintiff.<sup>3</sup>

It is to be noted that the Court treats of the obligation of the defendant as one created by statute, and not as resting

<sup>1</sup> Wood v. Wheelen, 93 Ill. 153 (1879).

<sup>2</sup> 4 B. & C. 961 (1825).

<sup>3</sup> See also *Gent v. Merchants Ins. Co.*, 107 Ill. 652 (1883); *Munson v. Ry. Co.*, 103 N. Y. 58 (1886); *Preston v. R. R. Co.*, 5 H. of L. 605 (1856); *In re Rotheram, L. J. N. S.* 219; *Low v. R. R. Co.*, 45 N. H. 385 (1864); *Ely v. Assn.*, 34 L. T. N. S. 190; *Caledonian Ry. Co. v. Helensburg*, 2 Macq. H. of L. 393 (1856); *Touche v. Metropolitan Ry. Co.*, 6 Ch. App. 671 (1870); *Hill v. Gould*, 129 Mo. 106 (1895); *Weatherford R. R. v. Granger*, 24 S. W. 795 (Texas, 1894).

upon the intention of the parties or the circumstances of the case. It is the force of the statute that obligates the company to make payment, although it is the contract made with the promoter that allows the plaintiff to bring his action in debt for a specific sum, rather than in the form of a *quantum meruit*, for the reasonable value of the services rendered. The case does not decide, therefore, that any liability would exist in the absence of statutory provision.

The American cases cited in the note usually treat of the obligation as resting upon the intention of the parties or the circumstances of the case, and give effect to the charter provision merely as allowing a recovery against the company. Such recovery would otherwise be denied, on the ground that the rights of shareholders would be impaired by permitting it, as they had no notice of these claims for services rendered prior to incorporation. The obligation exists under such a view independent of the charter, and there is no objection to enforcing it when the charter has protected the rights of innocent third parties taking stock, by warning them of the incumbrances upon the property which they are about to purchase.

It is held in England that the mention of the contract in articles of association, or even a statement contained therein that one of the objects for which the company is to be formed, is the payment of the plaintiff's claim, do not bind the corporation as do like provisions contained in the charter.<sup>1</sup> It would seem that the distinction drawn must be based upon the fact that the charter being an Act of Parliament is obligatory irrespective of contract, while the articles of association constitute at most only an agreement between the parties to them.

It would seem that from the point of view adopted by the American courts, as to the purpose and effect of such provisions, that articles of association duly recorded according to statute, should put purchasers of stock upon notice of prelimi-

<sup>1</sup> In *re* Empress Engineering Company, 16 Ch. Div. 125 (1880); *Howard v. Patent Ivory Mfg. Co.*, L. R. 38 Ch. Div. 156 (1888); In *re* Rotheram, L. J. N. S. 219; *Ely v. Association*, 34 L. T. N. S. 190.

nary expenses incurred in the formation of the company, as effectively as would a charter.<sup>1</sup>

§ 4. *Suggestion that company bound where all the projectors have contracted.*

It has been suggested (though what was said in the case was purely dictum) that, where all the stockholders of a corporation were parties to a contract made before organization, the company should be liable in equity upon the contract, on the ground that in substance, at least, the contract was made by the company itself.<sup>2</sup>

This theory, if permissible at all, could only be applied where no strangers to the contract had, subsequent to it, become interested in the corporation; for otherwise those would be charged who had no part in the transaction.<sup>3</sup> Since such a rule overlooks the distinction between the corporation and its members, there would seem little reason for its adoption, and, indeed, it has been expressly repudiated in at least two well-considered cases.<sup>4</sup>

§ 5. *Doctrine that corporation is in esse when charter granted but no organization has taken place.*

It has also been suggested that if, under a general incorporation law, articles of association have been taken out; or if a charter has been granted by legislative enactment, though organization has not taken place thereunder; in either case the corporation is sufficiently formed to be treated as being *in esse*, and may be bound by the acts of a majority of the corporators or promoters.

The idea originated in *Hall v. Vermont, Etc., R. R. Co.*,<sup>5</sup> in which case the Court said: "It may be true that the company was not invested with full corporate powers until after the stock was subscribed, and their organization perfected in the

<sup>1</sup> *Weatherford R. R. Co. v. Granger*, 24 S. W. 795 (Texas, 1894).

<sup>2</sup> *Paxton v. Bacon Mill Co.*, 2 Nev. 257 (1866).

<sup>3</sup> *Chicago Coffin Co. v. Fritz*, 41 Mo. App. 389.

<sup>4</sup> *Battelle v. Cement Co.*, 33 N. W. 327 (1887); *Little Rock, Etc., R. R. Co. v. Perry*, 37 Ark. 164 (1881).

<sup>5</sup> 28 Vt. 401 (1856).

choice of directors ; yet the corporation was *in esse* before the event ; it had an inchoate existence and the incorporators had the power and were so far the agents of the corporation as to bind them by any act which they were required to do, or which was necessary to perfect their organization under the charter."

While the result reached may be entirely justifiable, the grounds on which it proceeds involve considerable difficulty. It would seem that if the services were necessary to the company, and rendered with the expectation of compensation, the law would imply a promise to pay their reasonable value, and there would be no necessity for the Court to make use of the fictions of agency, and of corporate existence before organization.

The rule laid down in this case appeared as a dictum in *Low v. R. R. Co.*,<sup>1</sup> where it was said, (after a discussion of the above decision): "If it were true that, at the time the services were rendered, the corporation had no capacity to contract—which is by no means clear after the charter has been accepted—still, etc., etc.," and later: "The grantees named in the charter are the sole members of the corporation, until associates are admitted by them ; and they may, at a meeting duly called and holden, accept the charter and choose directors and other corporate officers. They may, indeed, proceed to discharge the duties devolved upon the corporation by its charter without the admission of any associates. It is obvious, then, that to bind the corporation by an acceptance of the charter, or other act the concurrence of at least a majority of the grantees or members is necessary."

It will be seen later that in the Pennsylvania case of *Bell's Gap R. R. Co. v. Christy*,<sup>2</sup> the Court under a misapprehension of this rule, as laid down in *Low v. R. R.*, have confused it with the rule that "a man will not be allowed to unjustly enrich himself at the expense of another," and instead of using the two theories disjunctively, as is done in *Low v. R. R. Co.*, have made the consent of a majority of the incorporators a pre-

<sup>1</sup> 45 N. H. 370 (1864).

<sup>2</sup> 79 Pa. 54. (1875).



requisite to a recovery in quasi-contract. The same anomalous doctrine is held in the later Pennsylvania case of *Tift v. Bank*.<sup>1</sup>

These latter cases, however, need not be further considered at this time, as they are not authorities for the proposition laid down in *Hall v. Vermont, Etc., R. R. Co.*; that proposition not having been understood as interpreted in *Low v. R. R. Co.*

Suffice it to say, that the rule under discussion has only been enunciated (as far as can be ascertained) in one other case,<sup>2</sup> and is now generally ignored. It has also been expressly denied,<sup>3</sup> and would seem to be out of accord with the general rule, that the corporate franchises remain in abeyance till all the requirements of incorporation are fulfilled.<sup>4</sup>

As to what requirements are essential, and what may be overlooked without causing a fatal flaw in the corporate structure, is a question somewhat foreign to the present discussion; suffice it to say that it has been held (under a general incorporation law) that where the final certificate has been issued, but not properly recorded, the company is *in esse* and bound by its acts.<sup>5</sup>

### CHAPTER III.

#### I. THE FORMER ENGLISH EQUITY RULE.

##### § 1.

Much of the confusion in thought which is apparent in the decisions upon the subject of corporate liability for the acts of promoters is due, it is believed, to a view formerly entertained in England and originating in the courts of equity, that a company is the successor to its promoters, stepping into their place and assuming all their rights and liabilities. Or, as the thought appeared later in a modified form, if the association of projectors and the corporation are not one and the same body in different stages of existence, the promoters are, at least, agents of the

<sup>1</sup> 141 Pa. 550 (1891).

<sup>2</sup> *Harrison v. Vt. Manganese Co.*, 20 N. Y. Supp. 894.

<sup>3</sup> *Gent v. Ins. Co.*, 107 Ill. 652 (1883); *R. R. Co. v. Ketchum*, 37 Conn. 170 (1858).

<sup>4</sup> *Dartmouth College v. Woodward*, 4 Wheat. 791.

<sup>5</sup> *R. R. Gazette v. Wherry*, 58 Mo. App. 423 (1893.)

company and can bind it for all purposes of organization. Now though, in these cases, the courts generally declared that the basis of their conclusion lay in the fact that the company had received a benefit and must assume the corresponding burden, they uniformly enforced the contract made by the promoters against the corporation, granting specific performance thereof (without regard to the actuality of the benefits accruing to the corporation), wherever it appeared that the party contracting with the promoter had fulfilled his part of the agreement. It would seem that, unless the Court conceived of the promoters as agents of the company with authority to bind it by contract, specific performance could not have been granted, however just it might be, to hold the company liable for the reasonable value of the plaintiff's land and services.

These cases will be considered at some length, because it is believed that the theory which they advance originated in a misapprehension of authority; and though this has been pointed out and the doctrine repudiated in England, the cases are not infrequently quoted in the American decisions. So far as they are to be taken to lay down the proposition that one cannot be allowed "to unjustly enrich himself at the expense of another," they are not to be questioned, but the results reached disprove the suggestion that this was the only principle invoked.

In the case of *Vauxhall Bridge Co. v. Earl of Spencer*,<sup>1</sup> Lord Eldon threw out the suggestion that the withdrawing of opposition to a bill in Parliament might, under certain circumstances, constitute a valid consideration for a contract.

A few years later, the case of *Edwards v. The Grand Junction R. R. Co.*<sup>2</sup> came up. Edwards, the complainant, filed a bill praying for an injunction to restrain the defendant company from completing its road until it had complied with the terms of a certain contract entered into with complainant by the promoters. There had been a preliminary organization of the company, and application made for a charter. Edwards and others, trustees of a turnpike company, opposed the bill in

<sup>1</sup>Jacob, 64 (1821); 2 Madd. 356.

<sup>2</sup>1 M. & C. 650 (1836).

Parliament. In consideration of the withdrawal of this opposition, the preliminary organization agreed that the company should construct and maintain a bridge of certain dimensions across the tracks for the pike to run over. To enforce this contract against the company the bill was filed.

Lord Cottenham, in delivering the judgment, said: "The objection to the bill rests upon grounds purely technical, and these applicable only to actions at law. The question is not whether there be any legal binding contract at law, but whether the Court will permit the company to use the powers under the act in direct opposition to the arrangement with the trustees before the act, and upon the faith of which they were permitted to obtain such powers. If the company and the projectors cannot be identified, still it is clear that the company have acceded to and are now in possession of all the projectors had before. They are entitled to all their rights and subject to all their liabilities. If any one individual had projected such a scheme and, in prosecution of it, had entered into an arrangement, and then had assigned all his interest in it to another, there could be no legal obligation between those who dealt with the original and such purchaser; but in this Court it would be otherwise. So here, as the company stands in the place of the projectors, they cannot repudiate the arrangement into which such projectors have entered in their corporate capacity; they cannot use the powers given by Parliament to such projectors and refuse to comply with those terms, upon the faith of which all opposition to their obtaining such powers was withheld." The injunction was granted, his lordship resting his decision on the case of *Vauxhall Bridge Co. v. Lord Spencer*, which, as we have seen, merely suggested that withdrawing opposition might be good consideration for a contract, but did not even hint that the company would be bound if the contract were made before incorporation.

Here, then, we have the bold annunciation of the theory, unsupported by any adequate authority, that the "company stands in the place of the projectors" and "cannot repudiate the arrangement into which such projectors have entered in their corporate capacity." And his lordship's statement,

"If the company and the projectors cannot be identified," etc., is no qualification of this position, for he goes on to say, "still it is clear that the company have acceded to and are now in possession of all that the projectors had before. They are entitled to all their rights and subject to all their liabilities." This is in effect making the projectors and the company identical, for the conception of the Court seems to be that the company, upon coming into existence, was substituted for the promoters, and that all those contracts which were binding upon the promoters were necessarily obligatory upon the corporation.

In the two later cases of *Stanley v. The Chester & Birkenhead R. R. Co.*,<sup>1</sup> and *Petre v. Eastern Counties R. R. Co.*,<sup>2</sup> in which the facts were practically the same, Lord Cottenham arrived at similar results upon the same reasoning, both being bills in equity. See also<sup>3</sup>

The doctrine was again advanced in the leading case of *Preston v. Liverpool & Manchester R. R.*<sup>4</sup> That was a bill praying specific performance of a contract entered into with the promoters of the company. Two associations were applying for charters to run roads over practically the same route. As only one charter would be granted, it was agreed between them that the successful applicant should assume all contracts made by the other with land-owners. The defendant company obtained the charter. The unsuccessful association had entered into an agreement with Preston for the purchase of his land. The defendant having changed its route somewhat, so that Preston's land was of no use to it, refused to buy or fulfil the contract. Preston filed this bill, to which the defendant demurred.

The Court said: "The doctrine in equity on this subject, where projectors of a company enter into contracts on behalf of a body not existing at the time of the contract but to be called into existence afterwards, is that if the body for whom

<sup>1</sup> 9 Simons, 264, s. c. 3 M. & C. 773 (1838).

<sup>2</sup> 1 Am. & Eng. R. Cas. 462.

<sup>3</sup> St. Leonard's opinion in *Hawkes v. Eastern Counties R. Y. Co.*, 4 Eng. L. & Eq. 91 (1851), where other cases are cited.

<sup>4</sup> 7 Eng. Law. & Eq. 124.

the projectors acted does not come into existence, it cannot take the benefit of the contract without performing that part of it which the projectors undertook that it should perform; that is, in substance, this Court treats the projectors for that purpose as agents of the company so afterwards called into existence." The demurrer was, therefore, overruled.

The case was appealed to the House of Lords on the construction of the contract, but was not reported till five years later.<sup>1</sup> In the meantime it was followed both here and in England, and is still very generally cited for the proposition that a corporation comes into existence *cum onere*, the fact having been overlooked, in a large number of instances, that the case was re-argued and a different result reached.

When the case came before the House of Lords on appeal,<sup>2</sup> Lord Chancellor Cranworth said: "The plaintiff's theory is, that the company comes into existence *cum onere*. I am aware that that is a doctrine acted upon by Lord Cottenham. . . . And it has been acted upon in so many cases that it would be very inexpedient offhand to say that that doctrine cannot be sustained, when one considers how much may have been done upon the faith of it. I must, however, own that when the subject comes to be very closely examined, I think there are objections of the gravest nature to its adoption, objections which do not seem sufficiently to have pressed upon the mind of his lordship. Lord Cottenham acted upon this principle that the railroad company was the successor of the projectors or the assignee, if one may say so, of the projectors, and must take existence subject to the burdens which had been contracted for by those who were the promoters of it and to whom it owed its existence. . . . Observe, my lords, to what this doctrine leads. There is that case of Lord Petrie, at which everybody starts when he hears it, in which there was a contract entered into by the projectors of a company that, if Lord P. would withdraw his opposition they would pay him £120,000 for that which was not worth above £4000. It may be that some of those who purchased the shares of that com-

<sup>1</sup> 5 H. of L. 605 (1856).

<sup>2</sup> 5 H. of L. 605 (1856).

pany were aware of that contract; but in all probability that was not the case with the majority. If this might be done once, as in the case of Lord P., it might have been done with ten other landed proprietors, and there would have been a million of the capital of the subscribers contracted away from them without any sort of knowledge upon their part and for purposes quite foreign from those for which they subscribed.

If, therefore, this case had turned upon the validity or non-validity of that doctrine, I should have desired of your lordship's further time to consider as to the course which was to be taken; but it does not."

The Court then proceeded to construe the contract and came to the conclusion that it was not a contract to pay £5000 for withdrawing opposition, but that plaintiff was to have received this sum if opposition were withdrawn and the land taken. That the taking of the land by the corporation was a condition precedent to its liability. That, as the land had not been taken, the contract fell, and it was not necessary to consider whether or not the corporation would have been bound if the contract had been interpreted differently.

Though the Court avoids expressly overruling the earlier cases, it is apparent from the fact that, by far, the greater part of the opinion is devoted to a stringent criticism of this doctrine promulgated by Lord Cottenham, that their dissent from it was intended to have the weight of authority. The case was argued at length and carefully considered, and the dictum expressed is so strong that it must be considered to have discredited the former rule.

The attitude of the Court upon the subject is even more clearly indicated in the opinion of Lord Brougham: "I have more than doubts of the soundness of those dicta, I may say of those judgments of my noble and learned friend, now no more; I have more than doubts. I think they were carrying very far, indeed, a great deal too far, certain doctrines which had themselves been the subject of dispute."

The specific performance prayed for was therefore refused.

In the same year 1856 the doctrine was again strongly assailed in the House of Lords, in the case of *The Caledonian*

*& Dumbartonshire Junction R. R. v. The Magistrates of Helensburgh.*<sup>1</sup> The Magistrates contracted with the "Committee of Management" of the proposed company, undertaking to extend the harbor of Helensburgh and erect a quay; the company to pay part of the expenses. The magistrates having performed their part, bring a bill for specific performance, the defense resting on the ground that the company is not bound by the acts of its promoters.

The Court said: The argument of appellee "proceeds on the ground that the Committee of Management ought to be treated in the nature of agents for the company, which owes its existence to their exertions, and when the company came into being it was, from its very birth, bound to fulfil the contracts by which its projectors had stipulated that it should be bound. This reasoning rests on the assumption that a railway company, when established by Parliament is, in substance though not in form, a body succeeding to the rights and coming into the place of the projectors. . . . When such a body applies, however, for incorporation, what they ask for is not an act incorporating themselves only, but all who may be willing to subscribe the specified sums and so become shareholders, and those becoming shareholders have a right to consider that they are entitled to all the benefit held out to them by the act and liable to no obligation beyond those which are there indicated. . . . If secret and unexpected terms are to be held binding on those who take shares, the result may be ruinous to those who act on the faith of what appears on the face of the legislative incorporation. . . . I can discover no principle, legal or equitable, whereby such contracts can be held to be obligatory on the company.'" "In holding that the company is a body different from its projectors in substance as well as form, I am acting on what is the mere truth, and no injustice can arise to those who have dealt with the projectors, for against them and all under whose authority they acted, there will be a clear right of action if the company does not fulfil the engagements which they have contracted that it shall perform, and that is surely all which those who

<sup>1</sup> 2 Macq. H. of L. Cases, 393 (1856).

have dealt with the projectors can claim as their right. For these reasons I am of opinion that on principle there is no ground for holding that a company is bound by any engagement made by those who obtained its act of incorporation, unless those engagements are embodied in the act of incorporation itself." After a careful consideration of all the authorities, the Court goes on to say: "I have stated my reason for thinking that such a doctrine rests on no sound principle and may lead as, in Lord Petrie's case, I think it did lead, to great injustice. And if, therefore, the case now to be decided was in all respects similar to the three cases I have referred to, what I should have to decide would be whether I should advise your lordships to adhere to the precedents established by Lord Cottenham, on the ground that it is unsafe to act against a series of decisions even though they may appear not to rest on any solid foundation, or to depart from them and to adopt what I consider a just and more correct principle." His lordship thereupon differentiated this case from the others on the ground that the contract to pay for erecting a quay and enlarging the harbor, though ultimately for the good of the company, was not within its powers, and that since even a contract made by the directors could not be enforced against the company under such circumstances, certainly one made by promoters could not be.

This decision, like that of *Preston v. R. R. Co.*,<sup>1</sup> while avoiding the necessity of overruling the former cases, is unstinting in its condemnation of the theory therein contained, and since its time the doctrine, that a corporation can come into existence subject to burdens imposed upon it by its promoters, has never found credence in England. It has been suggested, indeed, that the case of *Spiller v. Paris Skating Rink Co.*,<sup>2</sup> rested upon this ground, but that case came up on demurrer to a bill which charged that the defendant company had acted upon and adopted the contract made for it by its promoters, and that, therefore, the plaintiff was entitled to have the agreement performed. And the Court held, that the demurrer having

<sup>1</sup> 5 H. of L. 605 (1856).

<sup>2</sup> 7 Ch. Div. 368 (1878).



admitted the fact of adoption, the plaintiff was entitled to the relief claimed, and the demurrer was thereupon overruled. The only thing decided, therefore, was that *after* the company came into existence it might voluntarily *adopt* the contract and become bound under it. Whether or not such doctrine be sound, it is an entirely different theory from the one under consideration, for it involves the conception that the obligation rests upon the intention of the company as expressed in its voluntary act, whereas, in Lord Cottenham's view the corporation enters upon its existence, *cum onere*.

## § 2. *Not applicable at law.*

It has been asserted<sup>1</sup> that this doctrine was, in England, of general applicability and in vogue both in courts of law and equity, and Mr. Redfield, in support of this proposition, cites the case of *Howden v. Simpson*.<sup>2</sup> That was an action of debt brought by Lord Howden against Sir John Simpson and others, formerly projectors of a railroad company, upon an instrument, under seal, in which the defendants had agreed to pay the plaintiff £5000 for withdrawing his opposition to a bill granting a charter to the railroad. The only question involved was whether or not such a contract was legal, in view of the fact that Lord Howden was a member of Parliament at the time. No attempt was made to hold the company, so that the case does not support the proposition advanced.

Pointing to a contrary conclusion is the case of *Payne v. Coal Co.*<sup>3</sup> Promoters of the coal company, after provisional, but before complete registration, promised the plaintiffs that if they would give up their plan of organizing a similar company, they would see that plaintiffs should be made ship brokers for the defendant company when formed, and that said company would give plaintiffs a free passage to Australia. Assumpsit for breach of contract, in that the company refused so to do, though plaintiffs had performed their engagement in the matter.

<sup>1</sup> Redfield on Railroads, 5 Ed. p. 25.

<sup>2</sup> Keen, 583, 3 M. & Cr. 97, 10 Ad. & Ellis, 793, 9 Cl. & F. 61.

<sup>3</sup> 10 Exch. 281 (1854).

Platt, B., said, "I am clearly of opinion, that it was beyond the power of the provisionally registered company to bind the completely registered company by entering into the contract." This decision denies the applicability of the so-called equity doctrine of *cum onere*, to cases at law, at a time when that doctrine was at its height in the courts of equity, and it seems probable from the statements made in *Melhado v. Porto Algere Co.*,<sup>1</sup> and *Spiller v. Paris Skating Rink Co.*,<sup>2</sup> that the distinction in this respect between the two jurisdictions was always maintained.

The cases discussed in criticism of this doctrine, have dwelt largely upon the unfortunate practical results which would follow its adoption, the underlying thought being that if a company could be saddled with all the undertakings of its projectors, it would be brought into being, (through the incompetency or unscrupulousness of the promoters), in a condition unfit for the transaction of business, with the capital stock diminished or exhausted, and the stockholders (who could have had no notice of the transaction prior to incorporation) left without any adequate return for their money.

The doctrine seems also open to criticism on more theoretical grounds. It requires that the promoters be conceived of in one of two characters. Either as being in substance the corporation itself, as was suggested in the earlier cases on the subject, or as being agents of the company with power to bind it. It is clear that the conception in either case would be a pure fiction. That a corporation has no existence till it has received legislative sanction in some form or other, is well settled,<sup>3</sup> and it is a mere truism when one says that any body of persons applying for such legislative sanction in the form of a charter can, under no circumstances, be the corporation which they are endeavoring to create. Unless they are conceived of as, in fact, the same body, the conclusion that the corporation stands in the same position as the promoters with all their rights and subject to all their liabilities would seem to

<sup>1</sup> L. R. 9 C. P. 503 (1874).

<sup>2</sup> 7 Ch. Div. 368 (1878).

<sup>3</sup> Thompson on Corps., § 35.

be untenable. Again, it is well established that the corporation is distinct from the sum of its members,<sup>1</sup> so that what they might do in their individual capacities should not on theory bind the distinct and subsequently created company. This view is undoubtedly the one now generally adopted both in England and in this country.<sup>2</sup>

The theory of agency is equally untenable, for the correlative of "agent" is "principal" and there being no principal in existence the relationship cannot exist; and this is now uniformly acknowledged.<sup>3</sup>

Except as a fiction, therefore, this doctrine that a company can be bound before it is formed, and enters upon its corporate life "*cum onere*," must be considered unfounded in principle. As a fiction, the cases have shown that it works deplorable results. It is discredited in England, and has not been followed (as far as can be ascertained) since the decision in *Caledonian R. R. Co. v. Helensburgh*.<sup>4</sup> The American authorities repudiate it.<sup>5</sup>

There seems, then, to be no longer any distinction, either here or in England, between the doctrines existing in the law and equity courts. But though the doctrine has been abandoned in its original form, the thought has not entirely passed away in America, that a relationship of agency exists between the promoter and the corporation.

*Malcolm Lloyd, Jr.*

<sup>1</sup> Thompson on Corp., §§ 1-3.

<sup>2</sup> *Battelle v. Cement Co.*, 33 N. W. 327 (Mo. 1887); *Munson v. R. R. Co.*, 103 N. Y. 58 (1886); *In re Northumberland Avenue Hotel Co.*, 33 Ch. Div. 16 (1886); *In re Empress Engineering Co.*, 16 Ch. Div. 125 (1880).

<sup>3</sup> *Schreyer v. Turner Co.*, 43 P. 719 (Oregon, 1896); *Weatherford R. R. Co. v. Granger*, 24 S. W. 795 (Texas, 1894); *Long v. Bank*, 29 P. 878 (Utah, 1892); *Battelle v. Cement Co.*, 33 N. W. 327 (Mo. 1887); *Buffington v. Bardon*, 50 N. W. 776 (Wisc. 1891); *Joy v. Manion*, 28 Mo. App. 55 (1887); *Davis v. Maysville Creamery Assn.*, 63 Mo. App. 477 (1895); *Huron Printing & Binding Co. v. Kittleson*, 37 N. W. 233 (S. D. 1884); *Pittsburgh Copper Co. v. Quintrell*, 20 S. W. 248 (Texas, 1892).

<sup>4</sup> 2 Macq. H. of L. 393 (1856).

<sup>5</sup> Cases cited, *supra*.